A NATIONAL RESERVE ASSOCIATION AND THE MOVEMENT OF COTTON IN THE SOUTH

I

The South, through its ports—New Orleans, Galveston, Mobile, Savannah, and Charleston—is engaged in the importation of such products as coffee or bananas from South and Central America, and in the exportation of its main staple, cotton, to Europe. In both cases, the transactions give rise to credit instruments by which shipments of actual cash are saved. That is, bills of exchange (or drafts) from different countries are offset against each other in international bookkeeping with much the same general effect as are checks on different banks within our country offset against each other at our clearing houses. To show the probable working of a National Reserve Association upon southern business and banking, it will be well to discuss (*a*) the matter of exports; and later (*b*) that of imports. Under (*a*), the points taken up will be:

(1) A description of the present movement of cotton, and the bills of lading arising therefrom;
(2) The present financing of this movement by the banks;
(3) The evils of the present system;
(4) The remedies offered by a National Reserve Association and acceptances;
(5) The bills-of-lading question.

II

The total value of unmanufactured cotton exported from the southern states in 1910 was $450,447,234.00 (6,263,293 bales). Under present conditions, this movement of cotton is mainly financed through New York, and the profits thereby gained are variously estimated at several millions of dollars. The question has been raised whether the southern banks might not be able to do more of this business at home. Of course, this is a question, also, of the use of capital during the crop-moving season. At

present, the South itself does not possess available capital to meet the need when it comes.

In the technique of the cotton movement, it may be well to distinguish between (1) "domestic bills" and (2) "foreign bills": the former based on the operations within the country up to the arrival of the cotton at the port of shipment; the latter arising from the over-sea movement by ship. It is to be remembered that about one-half of the cotton produced is consumed at home. Hence domestic cotton bills between different parts of the United States are many; and they are also related to questions of warehousing, bills of lading, and the demand for credit. But time requires that this study should be confined to the cotton intended for exportation.

A cotton factor, or merchant, at some place like New Orleans, or Mobile, has cotton from various parts of the South sent him on consignment, or under some agreement as to price, to be sold. Or, a buyer sets out to purchase cotton in any part of the producing area. In such cases, the cotton comes in on a railroad bill of lading, running only to the domestic port, or place of shipment; and if this cotton is sold to an American mill, or to another shipper, only domestic bills of exchange arise. In case the factor sells any of this staple for export, he delivers it from the warehouse to the purchaser, who loads it on the ship and then obtains an ocean bill of lading. It may also happen that the foreign buyer himself may purchase cotton in the interior, and, wishing to see the actual goods, or collecting small shipments together at the seaboard, he may have the cotton sent to him on domestic railroad bills of lading; then, afterward, when he loads it on a steamer he obtains a separate ocean bill. Thus, two sets of bills of exchange and bills of lading arise, a "domestic" and a "foreign"; but each covers an entirely separate transaction. If this distinction is kept in mind, much confusion may be avoided in understanding the financing of the crop.

The method of handling cotton for exports varies, of course, according to the conditions prevailing at the moment. At times the foreign buyer may find it advantageous to buy the cotton from the supply which is always accumulating at the seaboard. But, as is well known there are throughout the producing area what

might be called inland cotton centers, such as Memphis, Dallas, and the like where the commodity is accumulated from the surrounding country. Consequently, the purchaser for foreign account may buy cotton at these interior points and ship it directly abroad on what is known as a through bill of lading. This bill of lading is issued by the railroad, and designates that the cotton is to be carried to the seaboard and thence by steamer to a specified foreign port. At the seaboard, such cotton is transferred without being touched by the shipper; but, when the cotton is placed on shipboard, the shipper obtains a document known as the master's receipt. This document, however, does not control the shipment nor enter into the negotiation of drafts. The bill of exchange on Europe is negotiated on the through bill of lading, which controls the delivery abroad in the same manner as a simple ocean bill of lading. In this case, one set of bills covers the entire transaction.

III

Such being the usual course of the cotton movement, it will be the next step to indicate the present method of financing these operations during the months from September to January.

In regard to the local cotton business, it is to be mentioned that the transactions are always in cash; hence a buyer, A, if of good standing, will arrange with his local bank to obtain funds if he wishes to purchase cotton. As is usual in this country, A will give his demand note, and secure it by warehouse (or compress) receipts, or by railroad bills of lading, covering a certain number of bales of cotton. Conservative banks will not advance on this form of security more than their capital stock and surplus; but this amount of credit is not adequate, and it makes the movement of cotton difficult. Moreover, if done, it is expensive. Payments for cotton are demanded in cash. Consequently, when A buys 1,000 bales of cotton and gets the loan for, say $60,000, the bank knows without any doubt that within three or four days it will be called on for $60,000 in currency, which must come out of its reserves, or must be shipped to the bank from the central reserve cities. When the cotton movement is over by January, this currency comes in, and must be returned again, chiefly to New York.

It is estimated that approximately $200,000,000 of currency is thus sent into the South, and again shipped back, during these four months, at a cost to country banks of possibly $40,000.

In the thirteen cotton-growing states, including Kentucky and excluding Missouri, there are 1,461 national banks with a combined capital stock of $159,927,430. When this capitalization is considered in connection with the value of the cotton crop it becomes immediately obvious why the South has to call on the North and on Europe for aid when the crop is to be moved. And, since the whole crop-moving period makes patent the insufficiency of American capital for all the demands—grain- as well as cotton-moving—put upon it, the inevitable resort is to Europe. The ninety-day bill of exchange is the usual form by which this borrowing is carried out.

In regard to financing exports of cotton and foreign buying, the operations are as follows: A cotton buyer, A, in the southern states, having borrowed as above described from his local bank, will now make a contract with a spinner abroad, or with a foreign cotton buyer (one who sells cotton to mills abroad), to sell him, say, 1,000 bales of cotton of a particular grade and staple, for shipment at a stipulated time and at a certain price. This price is usually what is known as "C.I.F. and 6 per cent," i.e., cost, insurance, and freight, and 6 per cent tare deducted. Having assembled the requisite number of bales, A takes out an ocean bill of lading for them, drawn to his own order, and stipulating that the steamship line shall notify the person abroad to whom he has sold them. He then makes up his invoice for the net amount which the foreign buyer should pay him and draws a draft (or bill of exchange) payable ninety days after sight to the order of himself, and indorsed in blank, which is called a documentary bill, because A attaches to it the ship's bill of lading, or the through inland bill of lading (as previously described, covering both railroad and steamship transportation), and a policy of insurance covering the shipment. This draft, or bill, is drawn either upon the cotton firm to whom he has sold the cotton, or upon a mill which purchased the cotton, or upon some bank which has been named as one that will accept the bill by arrangement with the

foreign purchaser. The southern cotton buyer, A, then presents these documents to a bank, which offers him (for a commission) the equivalent in dollars for whatever foreign money the bill may call for. By the proceeds of this sale of cotton to Europe, A has funds with which to take up his loan from a local bank, if he wishes.

Of course, foreign cotton bills may not be sold to a local bank in the South. A may sell through a broker in New York to some bank. Then the local bank, from which A first borrowed on his demand note, may draw a domestic bill of exchange, with the original documents (warehouse receipt) attached, on the New York bank. Thus, in another way, the local bank will gain the sum necessary to liquidate A's obligation to it. Of course, the broker in New York gets a commission for selling the bill of exchange; and the New York bank makes a profit on the bill of exchange. The bank then forwards this bill, or draft, to its correspondent abroad, who presents it to the person upon whom it is drawn, and has it accepted—this acceptance being made by writing across the face of the bill the word "accepted," with the name of the firm, mill, or bank, and the date. The bill of lading and the insurance policy are thereupon delivered to the accepting institution, and the acceptance is held for the account of the American bank which forwarded it; and it may be carried until its maturity, or it may be discounted in the foreign discount market and the proceeds placed to the credit of the bank in this country. Finally, the American bank can sell a demand bill against the proceeds of the discounted ninety-day bill, and thus obtain the funds to meet the bill on maturity, or, in the meantime, to continue similar operations.

IV

After this description of the existing methods of shipping and financing the cotton crop, the defects of the present system may here be briefly mentioned.

1. There is a lack of actual currency during the crop-moving period, and a plethora at other times. This lack arises from the inelasticity of our currency: greenbacks and silver are issued in fixed amounts; and the bond-secured national-bank notes increase (they do not decrease) according to the prices of bonds, irrespective

of the demands of the South or of any other community. To the extent that transactions are increasingly settled by checks rather than by actual cash, the conditions are changing for the better; for, as more banks are established in the interior of the southern states there is a greater use of checks; but at present, and, as this condition may not soon be changed, the movement of the crop calls for many millions in circulating notes.

2. Even when it is possible for northern banks to increase their note-issue, the annual requirement for currency to be sent in from outside during the movement of the crop brings with it certain expenses and difficulties. Since there is but one agency, and that at Washington, there is great delay and expense attached to the forwarding of national-bank notes. Moreover, the banks find it impossible at any time to change large notes for small ones, and vice versa, and, in consequence their customers are seriously inconvenienced. In addition, there is a high charge—seventy-five cents per thousand—for telegraphic transfers of currency from the New York Subtreasury to New Orleans.

3. The necessity of shipping actual cash into the South in the autumn months, and the expenses involved in this operation, are, in themselves, only signs of causes lying deeper down. In the main, these are two in kind:

a) One is the retention of really primitive conditions of exchange. Cash is required where credit-offsets might be more generally used. Because of the rigidity of our bank-issues, the inelasticity of our note system is painfully apparent. This is especially true in regions where checks are not generally used. No part of the country suffers more from the inelasticity of our note-issues than the South.

b) But the inelasticity of the notes is really traceable to a more fundamental cause. That cause is the patent insufficiency of southern capital to meet the exceptional demands of moving a crop valued at from $700,000,000 to $900,000,000. It is absolutely necessary to obtain credit from centers where the capital of the world can be drawn upon; that is, southern banks are obliged to call upon their large city correspondents for credit. In ordinary times, such credit is freely obtained; but, in any serious emergency —such as a real stress or panic—credit is actually unobtainable.

If credit were easily obtainable, then the transfer by check as a medium of exchange would be possible, even if notes were scarce. Hence, apart from the inelasticity of notes (which entails difficulties and expense), the fundamental difficulty is the inelasticity of credit. Even though cotton in bales is as good a basis of credit as anything in the world, the banks of the South are restricted in their operations by an existing system, which, the moment a strain is put upon it, cuts them off from accommodation when it is most needed. As soon as a southern bank's loans rise to a point where its immediate liabilities (in its deposit account) are no longer in the legal ratio to its lawful reserves, it must cease to lend for the moving of cotton. And, if large city banks are also restricted in the same way, they cannot lend to their country correspondents. It is unfortunately true that when the country banks are "loaned up," the city banks are likely to be in the same condition and for the same reason. The absence of any co-operative organization of credit, by which the reserves of all are put to the common service, hits the South in the cotton-moving period harder than any other part of the United States. That is, in any part of the country where capital is as yet insufficient for its needs, the lack is not so much a lack of currency as it is a lack of credit; for if the credit can be had, then a medium of exchange can be got, either in the form of checks or (with some delay and expense) in the form of notes. The remedy, therefore, must be suited to the need.

V

The plan of a National Reserve Association, in the form of a co-operative agency for all the banks—which is not a central bank—would enable any bank having cotton paper, accompanied by warehouse receipts or bills of lading, to obtain a rediscount at any branch of the Association. The proceeds of this loan might be had either in a credit on the books of the Association, or in the note-issues of the Association; and in either form (under proper restrictions) the borrowing bank would be able to use them in its reserves. The point of this operation would be that good cotton bills would carry with them the power to finance themselves, without resort to the aid of banks in the central reserve cities. That

is, cotton could be immediately transmuted into current funds during the period between its purchase and its sale. Such an institution could not be used for the promotion of syndicates, nor for carrying stocks and bonds, nor for providing funds to be used in speculation; because the only paper (in normal times) accepted for rediscount would be short-time commercial paper (such as ninety-day cotton bills). Such a plan, moreover, would be open to all banks, state or national, and the rates of discount to subscribing banks would be uniform throughout the Union.

This National Reserve Association would do no discounting with the general public, and hence would not compete for deposits with existing national and state banks and trust companies. Constituted in the common interest of all the banks, it would make the credit of the whole Association available to the banks in that part of the country where the special need might arise.

It is not always realized that the amount of business a bank can do is related, not to the volume of its capital and surplus, but to the quality of the paper it discounts. There is no possibility of undue expansion by a bank if its discounts are confined to credits based on cotton, in warehouse or in transit. Loans on such goods, by early sale for cash, carry within themselves the means of quick liquidation. Such paper is far and away safer than long-time bonds which do not fall due for a considerable period, and do not possess any advantage over other property in being convertible into cash. Such a co-operative agency as a National Reserve Association, therefore, is, by its very nature and operation, adapted to meet the peculiar difficulties which confront the South during the movement of the cotton crop.

1. It has been seen that cotton dealings are uniformly settled in cash; that the enormous burden of moving cotton causes the shipment of hundreds of millions of dollars of currency to and from the South in the autumn; and that the inelasticity of our note-issues makes currency scarce and high. Any demand for cash draws down the reserves of banks. When the surplus reserves are gone, the legal reserves cannot be paid out. In consequence, the banks cannot lend, even when good cotton bills are presented. This intolerable, humiliating, and rigid inelasticity of our cur-

rency would be entirely removed by a National Reserve Association. If a bank in Atlanta, Mobile, or New Orleans, during the crop-moving period, found its reserves down to the legal ratio, it could take cotton bills to the branch (not to New York banks) and obtain notes of the Reserve Association which it could hold or put into circulation. That is, notes would come into existence just in proportion to the need for them as the cotton was moved. Instead of a big crop-movement creating a money stringency, it would bring a corresponding supply of notes. Instead of a production of vast new wealth from the soil causing a stoppage of credit, it would, as it ought to, enlarge it, and bring prosperity with it. Then, since the notes of the Association would be redeemable on demand in gold or lawful money, their return for redemption should be forced by some provision which would make them costly to the banks to hold in reserves. Consequently, there would be the necessary contraction, after the demand for them had passed, which is as essential to elasticity as a ready expansion in time of need.

By such a co-operative association the South would be enabled to coin its own cotton into notes through its own local associations; and there would be no reason for the expensive shipment of cash to and from New York. Moreover, the South, thus made dependent only on itself would be freed from its present dependence for credit on New York, or on other central reserve cities. More than that, in its present dependence, the South is often not able to get the funds, even if it has the cotton paper to be rediscounted; but, under a National Reserve Association, it would be safely provided with currency, if it so desired, just in proportion to the amount of cotton bought and sold.

2. Not only would the co-operative organization of banks in a National Reserve Association provide elasticity of notes, but, more than that, it would provide an elasticity of credit. The one essential fact forced home on the South in the autumn is the inability to get credit. The value of the cotton crop is too great for her banking system to handle. But credit must be had. The bill of exchange for ocean shipments is the instrument used to get funds. How can the South get these funds, instead of feeling annually this aggravated constriction?

Under a National Reserve Association, aid would be given in a striking and effective way. Even if notes were not required, a bank, when threatened by a shortage of cash, would need only to present cotton bills having a short maturity to the nearest branch for rediscount. A credit would thus be created on which the bank could draw; or, the Association would even ship to it notes free of charge. All the items of present expense, as above enumerated, would disappear. The main point of this result should not be regarded as the convenience, or gain, to the local bank; the real substance of the new order would be the ability of the bank to accommodate its customers. Here is the crux of the whole matter: The persons to be benefited most are the borrowers, i.e., the cotton factors, the cotton growers, and the whole public dependent upon the industry—the farmer, the laborer, and the storekeeper. If they are enabled to realize on their crop, their purchasing power becomes evident at once.

Now why could a National Reserve Association work this miracle with the insufficient capital of the South? Simply because, as a co-operative agency, it would be enabled to call to its aid the mobilized reserves of the whole country to support an intense temporary demand; and because, by discounting bills for the banks, it could draw upon the capital of the North and of Europe. This capital would be available to the South whenever necessary, without begging for it, without asking for it, but as a natural outcome of the operation of the system. Why the South has not demanded some such institution long before is passing strange. Certainly there is no reason why it should remain content with dependence on New York, especially when, in times of emergency, that center responds to requests for aid only with the greatest difficulty.

It will be of interest to give here the opinion of a French banker, expressed to a friend in Atlanta, who is here quoted:

> He is manager of the second largest bank in France, and the fourth largest bank in the world. He said that he was in the South for the purpose of studying its banking methods, and, if possible, to obtain accounts for his bank; that, to his great surprise, he found that the banks in the South commenced to advance money to make the cotton crop as early as January, by supplying the farmers with funds to purchase mules and fertilizer, and that such security as we took from farmers would not be considered good in his country; that we

advanced a large amount of funds for labor in planting the cotton crop, which might never materialize, or be injured to a great extent, thereby making our collateral subject to weather conditions; that later on we advanced further large sums for the purpose of picking the cotton and preparing it for the market, and this he did not consider good security. After the cotton is picked and ready for market, the southern banks advanced more funds, taking as security inadequate warehouse receipts. In fact, our entire system of banking was based upon the problematical security of a growing crop, which is not always certain. He stated, further, that, to his great surprise, he found that when the cotton is shipped and the security put in the form of a sixty- or ninety-day bill on bankers in Europe (which is in every respect equivalent to a demand on the Bank of England or the Bank of France), we southern bankers will not advance a dollar on the security and the only explanation he could get was that we did not know how to do it; and this is a simple truth. We take all the risk of growing the crop, and the poor warehouse system, and when we get a document on which there is absolutely no risk, we refuse to handle it, and let this gilt-edged security go to New York, where it is handled at a good profit.

Further, by the instrumentality of a National Reserve Association, the financing of the cotton crop could be accomplished at home; the cotton bills could be drawn and sold by Southern banks; and all the profit on handling the export of cotton could go to them, rather than to New York.

3. It is to be remembered, also, that the National Reserve Association should be empowered to deal in foreign bills of exchange, provided they arise from commercial transactions (as opposed to dealings in investment securities), and bear at least two responsible names. In such a case, with an agency in London, the gain from the transactions would accrue almost entirely to home institutions. A bank in the South having bought a cotton bill on a firm in England could forward it to the London branch, which would present the bill to the acceptor. The accepted bills then in the hands of the Branch could be discounted in the open market in London, or in New York or Chicago. Thus the profit would be gained by the National Reserve Association, rather than by a foreign bank. Yet in this case, as elsewhere, the bill of exchange would enable foreign credit to be used in and for the South.

4. In the proposals for banking reform, it is also intended to allow all banks, under proper restrictions, to create acceptances. That is, instead of borrowing in the form of a demand note, the

borrower, A, would make an arrangement with his bank to buy a bill drawn on A by B (the planter), or accept one drawn by A on his bank. Thereby, when accepted, the bank would assume the risk of repayment, and give the paper uniform security wherever the bank was known. The quality of the paper would no longer vary with the standing of the individual borrowers, but would be as good as the bank that accepted it. Consequently, such acceptances could be sold to investors in any discount market, at home or abroad, where the bank was known.

For instance, a cotton merchant, at Greenwood, Miss., might arrange with his home bank, or with a bank in New Orleans, or in some other city, to grant him credit for $60,000. He would draw a bill of exchange, or draft, on the given bank at sixty or ninety days, to which would be attached the warehouse receipts. When this bill had been accepted, the paper could then be sold in any open market; and the bank could obtain at any time funds for such bills. So long as the credits were based on actual warehouse receipts, there could be no overexpansion. Overexpansion could arise only if acceptances were granted without the actual security.

Obviously, the introduction of acceptances, which would also be handled by the Branch of the National Reserve Association, would enable a bank to provide for a customer a credit instead of currency (or notes of the National Reserve Association, if so desired). Hence, a southern bank could with safety extend loans based on actual cotton receipts to two and a half or three times the amount of its capital and surplus. Consequently, the lending power of the southern banks in the crop-moving period would be doubled or trebled, not only to their own profit, but to the advantage of their customers, and the whole people.

5. Since these acceptances could be sold in the open discount market for prime bills, they would command a low rate of discount; and, if negotiated in Europe, the South would obtain its capital for crop-moving purposes at the low European rate, rather than at the higher New York rate (as at present). If the southern banks could thus borrow at low rates on acceptances, they could grant lower rates than now to the merchants and farmers who form their constituency. For a small bank could borrow at the National

Reserve Association at exactly the same rate as the large central reserve city bank. That brings out the democratic character of the proposed National Reserve Association.

The importance to the South of this uniform rate of discount by the National Reserve Association cannot easily be exaggerated. As things go now, the idle funds of local banks go to New York banks, are there loaned on call, and used for stock speculation. If acceptances were made possible, under proper restriction, and idle funds were directed to buying them in the open discount market at, say 4 or 4½ per cent, instead of the 2 per cent obtained on New York deposits, the banks, as well as the borrower, would gain; the former getting a higher rate, and the latter a lower rate, than now. More than that, the flow of funds into call loans, as at present, makes the rate which the mercantile borrower pays depend upon the rates current on stock exchange. But, with a National Reserve Association rediscounting only commercial paper, and with acceptances to be had in the open market, the mercantile borrower would be protected against aberrations due to the excitements of stock exchange speculation. Not infrequently, in times of emergency—when a borrower is most in need—the rates in New York have advanced as high as 100 or 150 per cent. Likewise, the variation in the rates throughout the United States is wide, even in normal times:

New York, 2½–3 per cent.
Chicago, 3½–4 per cent.
Atlanta, 5–6 per cent.
Macon, 6–7 per cent.
Greensboro, 8–10 per cent.
Smaller towns, 12–15 per cent.

Under a system by which mobilization of reserves was made possible, the rates to banks in the smaller towns, on the same kind of security, would be as low as to the large bank in New York or Chicago.

6. The effect of the National Reserve Association would be far-reaching in many ways. At present, the central reserve city banks value the accounts of their correspondents according to the amount of their deposit accounts with them. The rules of the New York

banks as to balances and discounts regulate the amount of credits to the southern banks. And at some times in the year their funds in New York are available to them only at a discount.

But if bills and acceptances were made in the South and forwarded direct to London by the southern banks, the South would have credits in London for sale. This practice would eliminate the commission of the New York broker, and the southern banks would retain for themselves the profit of the New York banker. Having cable advices as to rates of discount with their European correspondents, the southern banks could make a price for exchange to the local cotton exporter. Having accounts in London, Paris, Berlin, or Bremen, the southern bank could buy bills on Europe, forward them to its European correspondent, where the rate charged would be the European (not the American) rate; on this account it could draw its clear demand bills, or cable transfers. That is, it could sell its European credits wherever in the world (New York, Chicago, Rio Janeiro, Buenos Aires, Montreal, or Havana) credits on Europe were desired. For example, if Brazil were buying manufactured goods from London, and exporting coffee to New York; and if the South were exporting cotton to London; then the southern bank could sell a London credit (in sterling) to Rio; and the Rio bank could cable New York to place the sum (in dollars) to the credit of the southern bank. This whole arbitrage transaction could be completed in twelve hours.

As compared with a New York account, the London account is more satisfactory to the southern bank. It is not so much a question with the London banker what the amount of the balance with him is; he is not rediscounting, as is the New York banker; he permits the southern bank to draw on him, and he simply accepts the bill, charging for the period it is carried a rate of preferably $1\frac{1}{2}$ to 3 per cent—a rate much lower than that of New York. The London banker values the account according to the amount of acceptances he gets; the greater the number and amount of bills, the greater his commissions. The credit is forthcoming in exact proportion to the need; while in New York it is dependent largely on the amount of balances held, or on the rigid system of reserves.

VI

Finally, we come out upon the bill-of-lading question, which has recently occupied so much attention since fraudulent bills were disclosed and efforts were made by foreign bankers to force a guaranty of the genuineness of the bills of lading before discounts were granted.

The risk to the American banker which is attendant upon such transactions is primarily whether or not the cotton was actually sold by the buyer in this country to the buyer abroad; and secondly, whether or not the firm upon which the draft is drawn really authorized its acceptance. It is therefore incumbent upon the American banker to be thoroughly acquainted with the person from whom he buys, satisfied of his integrity and convinced that he would not offer for sale a bill of exchange drawn against cotton which had not been actually sold, nor draw upon a firm or bank which had not agreed to accept it. The American banker operates upon the theory that his responsibility as to the validity of all the documents ceases when the bill has been accepted; and the only responsibility he runs thereunder is by reason of his indorsement on the bill, in the event of the failure of the accepting bank or firm.

The risk to the foreign cotton merchant lies in whether or not the American cotton buyer from whom he has purchased the cotton is honest and responsible. He may be defrauded in various ways:

(1) The foreigner may have purchased the cotton at a stipulated price and the American buyer may never deliver it to him, if the market advances sharply and the transaction would show a serious loss;

(2) The American may deliver him cotton of a lower grade than that which he purchased, and draw for the value of the higher grade;

(3) He may ship him cotton of less weight than that for which he draws;

(4) He may make out a fraudulent bill of lading by signing the name of an interior agent, and draw against the cotton without ever having shipped it.

It is therefore incumbent upon the foreigner to be thoroughly

informed as to the firm or person from whom he buys, i.e., in the same manner in which it is necessary for anyone extending credit to be conversant with the affairs of the person with whom he is dealing.

The risk to the foreign banker who has agreed to accept such documents lies in whether or not the foreign spinner or cotton merchant for whom he has agreed to accept is financially responsible and able to pay the draft, even though the cotton may never have been shipped. He is, therefore, required to exercise his judgment in the same manner as when extending credit upon any other piece of negotiable paper. In the main, the risk arising from the possibility of fraudulent bills of lading is no greater than the risks which the banks assume every day in the chance of paying forged checks.

If the European methods, by which the buyer of cotton arranges with his bank to accept bills drawn at thirty, sixty, or ninety days against shipments of cotton, were generally introduced into the South, much of the fear as to fraudulent bills of lading would disappear. The local southern bank would be most careful to see that the bills of lading were genuine, if it accepted the bill and assumed the risk; and its facilities for insuring genuineness are apparent. The main source of difficulty has arisen from the fact that the cotton bills now usually pass through New York banks, which obviously do not have the means of verifying the bills of lading, as do the banks in the cotton district. The attempt of the English bankers to force the responsibility home upon the New York bankers has its origin in the same general cause. Were cotton bills generally accepted by southern banks, the risk would be placed where there is the least chance of deceit, i.e., on the accepting banks. If desired, the American banker could insist upon holding the bill of lading until the cotton arrived at destination, and requiring that it should be placed in the warehouse, insured for his benefit, and paid for only when withdrawn from the warehouse by the mill. Such a procedure is usual in handling imports, such as coffee. Such a method could be successfully carried out by southern banks, and they could transact a very much larger business than now, were there established a National Reserve Association at which an accepting bank could rediscount

its own acceptances; or if there existed a general discount market for acceptances.

VII

Lastly, we may briefly discuss (*b*) the relation of the financing of imports to the National Reserve Association.

A in New Orleans purchases coffee ($10,000) from B in Rio Janeiro. A wishes a time loan on this coffee in order to be able in due course to pay for it out of the proceeds of its sale. A applies to Bank X in New Orleans for a credit in London, which he can transfer to B's order; because, as Brazil buys its goods in Europe rather than in the United States, it wishes to use its proceeds from exports of coffee to the United States in payment of its debts to Europe. Bank X grants this loan to A by instructing its correspondent bank, Y, in London to accept drafts (or bills of exchange), usually running ninety days ahead, drawn by B in Rio Janeiro on London to the amount of $10,000. Bank X guarantees to Y the payment at maturity of this draft. The charge for this credit to A is made in the form of a commission of ½ of 1 per cent ($50), of which ¼ of 1 per cent ($25) goes to the London bank, Y.

The London bank, Y, receives the draft from B in Rio accompanied by the bills of lading and the insurance certificates of the coffee sent to A in New Orleans. Bank Y accepts the draft, but sends the bills of lading, etc., to its correspondent, X, in New Orleans. Then A must pay Bank X for the coffee. This may be effected in one of several ways: (1) A may pay in cash, less the discount at the London rate to date of maturity; or (2) A may leave the documents with Bank X until the coffee arrives; or (3) A may take the coffee out on a trust receipt, place the coffee in a warehouse, and give Bank X the warehouse receipts as security; or (4) A may be given the coffee on trust receipt, and allowed to sell it, the bank arranging to be paid by A fifteen days before maturity of the bill in London. Thus A expects to get the means of payment for the loan by a credit based on the sale of the coffee.

If acceptances by national banks were legalized under the National Reserve Association act, a national bank, X, could itself accept these drafts from Rio directly, without asking London to do it. This paper would have on it the name of the Brazilian

exporting house, and of Bank X which accepted it, and it would be guaranteed, also, by the importer, A, in New Orleans. If Bank X accepted the Rio draft, Bank X could provide A with a bill of exchange on London which A could transmit to Rio in payment of the coffee. Then from the proceeds of the sale of the coffee A could pay off his obligation to Bank X. As is well known, such a use of credit instruments would prevent the needless shipment of actual cash. By this method the profits of accepting bills would be transferred from London to New Orleans. Of course, any state bank or trust company, not being under the jurisdiction of the National Banking Act, could do this business today; and it is coming to be understood by some enterprising state bankers in the South.

The outcome of the whole matter is that the National Reserve Association would by evolution carry to a wider field of operation the principles of the clearing-house associations, and save the needless movement of actual cash, not merely between banks in the same city, but between different portions of the country. Thus the crop-moving period would no longer be a time of a great shifting of money reserves, and a time of stringency, but a season of prosperity and increased purchasing power.

J. LAURENCE LAUGHLIN

THE UNIVERSITY OF CHICAGO